

Internal Revenue Service
Director, Exempt Organizations

Department of the Treasury
P.O. Box 2508 - EP/EO
Cincinnati, OH 45201

Date: [REDACTED]

Employer Identification Number:
[REDACTED]

Person to Contact - I.D. Number:
[REDACTED]

Contact Telephone Numbers:
[REDACTED]

Phone
FAX

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Decision.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

A declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,

A black rectangular redaction box covering the signature of the Director of Exempt Organizations.

Director, Exempt Organizations

Enclosures: (3)
Enclosure I
Publication 892
Form 6018

Enclosure I

Issues

You are not operated exclusively for 501(c)(3) purposes for the following reasons:

- a. You are organized to provide supplemental [REDACTED] staffing needs at competitive prices. You operate as an employment agency for the benefit of your members. As such, your functions are substantially similar to those of a commercial employment agency. Thus, you are engaged in a regular business of a kind ordinarily carried on for profit.
- b. You were created and controlled as a successor to a for-profit. When the purchaser is controlled by the seller, there can be no presumption that the transaction represents fair market value because the elements of an arm's length transaction are not present. You are operated for the benefit of private parties which constitutes a substantial nonexempt purpose.

Facts

Your Articles of Incorporation show you were incorporated [REDACTED] in the State of [REDACTED]. Your Articles of Incorporation state you were organized for:

- a. The specific purpose for which the corporation is organized are to operate a [REDACTED] which will comply with the regulations in regard thereto of the United States Department of Health, Education and Welfare ("HEW") promulgated under Title 42 of the United States Code, to provide for the furnishing of [REDACTED] services to patients (including intermittent [REDACTED] service) sufficient to meet [REDACTED] needs, therapeutic and residential services, the maintenance of [REDACTED] records on all patients and the institution of policies to govern the above services which shall be developed and reviewed by a professional group which shall include at least one physician and a registered nurse to carry on any business in connection therewith and which are not forbidden by the laws of the State of [REDACTED]

Your By Laws Article IV Section 1 indicates, in part, services to be provided include professional nursing services.

Your Form 1023, Application for Recognition of Exemption, page 2 item 1 states:

[REDACTED], founder, president, and CEO, established [REDACTED] in [REDACTED]

The initial focus of [REDACTED]

[REDACTED] In [REDACTED], we received our [REDACTED] and [REDACTED] certifications from the Department of [REDACTED] validating our status as A full-service [REDACTED].

Your letter dated [REDACTED] states you were formed as a sole proprietorship in [REDACTED]. It further states that you are a referral source to entities that assist [REDACTED] and [REDACTED] patients.

Our letter dated December 6, 2002 requested completion of Schedule I of Form 1023 since you were a for-profit successor.

Your letter dated [REDACTED] stated the sole proprietorship; [REDACTED] was not making any profit and had been closed for a few years. On [REDACTED] the sole proprietorship was then transferred to the newly formed corporation.

Schedule I of Form 1023 discloses the nature of the predecessor organization was to provide professional health care assistance to local community. It further states the owners of the predecessor organization were [REDACTED] and [REDACTED] who are related as mother and son. The Agreement of Sale indicates the predecessor organization, [REDACTED] was sold to you on [REDACTED] and [REDACTED] and [REDACTED] were listed as seller and [REDACTED] as buyer. The agreement of sale does not indicate any new operating policies were initiated as a result of the transfer of assets from a profit-making organization to a nonprofit organization and that [REDACTED] remains president/CEO.

Information submitted with your response of [REDACTED] indicates you staff only qualified professionals who possess the appropriate expertise and professionalism to enhance your services. You are an extension of your customer's staffing needs.

Information submitted with your response of [REDACTED] indicates your services are competitively priced to ensure the best supplemental staffing professionals at the most cost-effective prices. You meet State and Federal requirements for supplemental staffing organizations and you provide staff relief on a 36-month contractual basis.

Law

Section 501(c)(3) of the Code, provides in part, for the exemption from Federal income tax organizations organized and operated exclusively for charitable, religious or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Regulations states in order to qualify under section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more exempt purposes. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for any exempt purpose unless it serves a public rather than a private interest.

Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), held that the presence of a single nonexempt purpose, if substantial in nature, will preclude tax exemption under section 501(c)(3) of the Code.

Operating for the benefit of private parties constitutes a substantial nonexempt purpose. Old Dominion Box Co. v. United States, 477 F. 2d 340 (4th Cir. 1973), cert. denied 413 U.S. 910 (1973).

Leon A. Beeghly v. Commissioner, 35 T.C. 490. (1960), provided that where an exempt organization engages in a transaction with a related interest and there is a purpose to benefit the private interest rather than the organization, exemption may be lost even though the transaction ultimately proves profitable for the exempt organization.

Living Faith Inc. v Comm'r, 60 T.C.M., 710, 713 (1990), aff'd 950 F.2d 365 (& Cir. 1991) The court wrote that its activities were conducted as a business and the organization was in direct competition with other restaurants and health food stores and thus did not qualify under Section 501(c)(3). The court also concluded that competition with commercial firms is strong evidence of a substantial nonexempt commercial purpose.

Easter House V. United States, 87-2 U.S.T.C

In this case, court refused to grant tax-exempt status to an adoption agency on the ground that it operated in a manner indistinguishable from and in competition with commercial entities.

In Revenue Ruling 61-170, 1961-1 C.B. 112, an association composed of ~~professional~~ private duty nurses and practical nurses which supported and operated a nurses' registry primarily to afford greater employment opportunities for its members was not entitled to exemption under section 501(c)(3) of the Internal Revenue Code. Although the public received some benefit from the organization's activities, the primary benefit of these activities was to the organization's members. Revenue Ruling 61-170 can be contrasted with Revenue Ruling 65-298, 1965-2 C.B. 163. In Revenue Ruling 65-298 a non-membership organization provided seminars to members of the medical profession. These seminars were designed to lessen the time between the discovery of medical knowledge and its practical application. Unlike the organization in Revenue Ruling 61-170, the benefits flowing from the activities of the medical seminar organization were of direct benefit to the general public. Revenue Ruling 66-360, 1966-2 C.B. 228 concerns a sorority that is created and controlled by a business corporation engaged in furnishing services and supplies to the sorority and its member chapters. The corporation had control over the sorority and member chapters because it had

control over the national sorority's governing board. The corporation used this control to carry on a commercial enterprise consisting of furnishing services and supplies to the national sorority, its chapters, and individual members. Neither the sorority nor its chapters qualified for exemption from income tax under section 501(c)(4) or section 501(c)(7) because it served the financial interests of the corporation.

Revenue Ruling 76-91, 1976-1 C.B. 149, concerns the purchase, in a transaction not at arm's length, of all the assets of a profit-making hospital by a nonprofit hospital corporation at a price that includes the value of intangible assets, determined by the capitalization of excess earnings formula. The ruling concludes that the transaction does not result in the inurement of the hospital's net earnings to the benefit of any private shareholder or individual or serve a private interest precluding exemption under section 501(c)(3) because an acceptable method was used to value the assets. The revenue ruling states that where the purchaser is controlled by the seller or there is a close relationship between the two at the time of the sale, there can be no presumption that the purchase price represents fair market value because the elements of an arm's length transaction are not present.

Revenue Ruling 76-441, 1976-2 C.B. 147, presents two situations concerning school operations. In the first scenario a nonprofit school succeeded to the assets of a for-profit school. While the former owners were employed in the new school, the board of directors was completely different. The ruling concludes that the transfer did not serve private interests. Part of that conclusion was based on the independence of the board. In the second scenario, the for-profit school converted to a nonprofit school. The former owners became the new school's directors. The former owners/new directors benefited from the conversion. The ruling concludes that private interests were served. The conclusion is stated as follows:

The directors were, in fact, dealing with themselves and will benefit financially from the transaction. Therefore, (the applicant) is not operated exclusively for educational and charitable purposes and does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code.

Application of Law

Section 501(a) provides an exemption from federal income tax for organizations described in Section 501(c)(3).

An organization is described in Section 501(c)(3) if it is organized and operated exclusively for religious, charitable, scientific testing for public safety, literary or educational purposes or to foster amateur sports.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations defines the term "charitable" as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration.

Section 501(c)(3) sets forth two main tests for qualification for exempt status. An organization must be both organized and operated exclusively for purposes described in Section 501(c)(3). You will not be operated exclusively for charitable purposes if you are organized and operated as a business. Your organization does not satisfy the operational test. Your organization is not operating exclusively for charitable purposes since you are operated in a commercial fashion indistinguishable from a for-profit organization. You are also serving the private interests of your founder, J. Edward Jackson II and your member nurses by conferring to them the benefits of tax exemption under Section 501(c)(3).

You are operated for the purpose of benefiting your founder and member [REDACTED]. The presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes. Better Business Bureau of Washington, supra.

You are like the organization described in Old Dominion box Co. V. Unites States, supra. You are operating to confer the benefits associated with tax-exempt status under section 501(c)(3) to further the private interests of your founder and member [REDACTED].

[REDACTED]

You are like the organization described in Leon A. Beeghly v. Commissioner, supra. Your founder created you after his sole proprietorship did not make any profit and closed.

You are like the organization described in Living Faith Inc. v Comm'r, 60 T.C.M., 710, 713(1990), aff'd 950 F.2d 365 (& Cir. 1991), supra. The court wrote that its activities were conducted as a business and the organization was in direct competition with other restaurants and health food stores and thus did not qualify under Section 501(c)(3). The court also concluded that competition with commercial firms is strong evidence of a substantial nonexempt commercial purpose. You are competing against every other entity that provides supplemental [REDACTED] needs at competitive prices.

Like the organization described in Easter House V. United States, supra, you have failed to distinguish yourself from any other supplemental nursing staffing agency. Information submitted with your response dated March 18, 2003 indicates your services are competitively priced to ensure the best supplemental staffing professionals at the most cost-effective prices.

The private benefit concept has been the subject of several revenue rulings. For example, Revenue Ruling 61-170, supra, discusses an organization having both a charitable and non-charitable purpose. While nursing the sick was recognized as a charitable activity, the Internal Revenue Service determined that finding employment for nurses bestowed a substantial private benefit on the participating nurses who controlled the organization. Thus, the charitable nature of the activity was undercut by the benefits flowing to private individuals. Revenue Ruling 66-360, supra, the Internal Revenue Service ruled that an organization which was created and controlled by a for-profit that engaged in furnishing services and supplies to the organization is not an exempt organization. [REDACTED]

[REDACTED] your founder, like the for-profit in the Revenue Ruling, exercises control over you because he: (1) created you, and, (2) has control over your governing board. Situation 2 of Revenue Ruling 76-441, supra, presents a fact pattern that is somewhat similar to your situation. The directors of a for-profit school converted the school to a non-profit school that they controlled. The Internal Revenue Service determined that the directors had structured the conversion so as to benefit themselves and ruled that the organization was not operated exclusively for exempt purposes. Revenue Ruling 76-91, supra, explains that the presumption of an arm's length arrangement is negated when the seller controls the purchaser. There is no rule forbidding one individual from controlling a charity and a for-profit entity.

But, when the situation occurs, it is the duty of the exempt organization to act with the highest degree of fiduciary responsibility to counter the presumption.

Applicant's Position

Your letter dated [REDACTED] outlines the position of your organization with regard to qualification for tax exemption under section 501(c)(3) of the Internal Revenue Code. You state:

To do services for the at risk communities, we must Be a non-profit contractual organization with the Federal, county and state agencies according to the Guidelines of the Title 42, 22, 17 and 8 of the Code of regulations.

Your letter dated [REDACTED] further claims that your organization meets the requirements of section 501(c)(3) of the Internal Revenue Code because to fulfill your stated mission benefiting the at risk communities you need to be tax exempt under section 501(c)(3) of the Internal Revenue Code to:

- Collect charitable contributions,
- Qualify for private and public grants and other subsidies,
- Produce profits from engaging in activities related to the mission of the organization (including fund raising events)

Services response to applicant's position

Your letters dated [REDACTED] and [REDACTED] asserts that your organization meets the requirements of section 501(c)(3) of the Internal Revenue Code because you are organized and operated for 501(c)(3) purposes. Based on the information submitted, it is our position that your organization is not operated exclusively for 501(c)(3) purposes and as a result, tax exemption under section 501(c)(3) is precluded.

You are organized to provide supplemental [REDACTED] staffing needs at competitive prices. You operate as an employment agency for the benefit of your members. As such, your functions are substantially similar to those of a commercial employment agency. Thus, you are engaged in a regular business of a kind ordinarily carried on for profit.

[REDACTED]

You were created and controlled as a successor to a for-profit. When the purchaser is controlled by the seller, there can be no presumption that the transaction represents fair market value because the elements of an arm's length transaction are not present. You are operated for the benefit of private parties which constitutes a substantial nonexempt purpose.

The fact that your organization is [REDACTED] the sick, a charitable activity, is outweighed by the substantial nonexempt purpose of engaging in a regular business of a kind ordinarily carried on for profit and promoting the private interests of your founder and member [REDACTED]. As a result, your organization is not operated exclusively for 501(c)(3) purposes and recognition of tax exempt status under section 501(c)(3) of the Internal Revenue Code is precluded.

Conclusion

Based on the facts presented above, we hold that your organization does not meet the requirements for tax exemption under section 501(c)(3) of the Internal Revenue Code.

Based on the facts that you have provided in your application for recognition of exemption, we are not able to conclude that you are organized and operated exclusively for public rather than private purposes. The fact that some of your activities further charitable purposes does not detract from the existence of the substantial nonexempt purposes of promoting the private interests of your founder, [REDACTED] and your member [REDACTED]. Despite any charitable purposes your activities may achieve, you cannot qualify for exemption because more than an insubstantial part of your activities is not in furtherance of exempt purposes.

Accordingly, you do not qualify for exemption under section 501(c)(3) of the Internal Revenue Code because you do not meet the proscriptions in sections 1.501(c)(3)-1(a)(1) and 1.501(c)(3)-1(d)(1)(ii) of the Regulations.